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EMPLOYEE BENEFITS

Section 125 Cafeteria Plan Document Amendments

Due 12/31/21

December 2021

In response to the COVID-19 pandemic, the IRS released guidance permitting additional flexibility for employer plan sponsors of Section 125 cafeteria plans. The guidance, released in Notice 2020-29 and Notice 2021-15, specified that if employers implemented any of the available changes, they were required to adopt a plan amendment to their Section 125 cafeteria plan documents. In addition, the guidance gave plan sponsors until December 31st of the next calendar year following the year in which the change is effective to adopt these amendments. Generally, Section 125 plan document amendments are required to be formally adopted by the plan sponsor before they become effective. However, the IRS has clarified that amendments adopted in response to these notices can be adopted retroactively. To do this, the plan must operate consistent with the terms of the amendment during the period beginning on the effective date of the amendment and ending on the date the amendment is adopted. The details of the options released in the IRS notices requiring a plan amendment to be adopted by December 31, 2021, are discussed in more detail below.

Notice 2020-29

Special Cafeteria Plan Election Change Rules

The pre-tax election changes outlined below were permitted during the calendar year 2020, even if the employee did not experience an event that would usually be required under the Section 125 regulations to make a pre-tax election change. Employers were permitted to limit the timeframe in which employees could make the permitted changes. This flexibility applied to the 2020 calendar year. Amendments should reflect the effective date (as early as 1/1/2020) and the date upon which these permitted changes were no longer available (as late as 12/31/2020). Amendments formalizing changes affecting elections for the plan year ending in 2020 must be adopted by December 31, 2021.

The pre-tax election changes:

1. Prospectively allow employees that previously waived coverage to make a new election for health coverage.
2. Prospectively allow employees to change their health coverage election from one coverage option to another (e.g., from a PPO to an HMO) and change their coverage tier (e.g., from self-only coverage to family coverage).
3. Prospectively revoke an election for health coverage provided that the employee attests in writing that they are enrolled, or will immediately enroll, in the health coverage of another plan sponsor (employer/individual/government).
4. Prospectively revoke, decrease, or make a new election for a health FSA or dependent care assistance program (DCAP).
    a. A reduction in election for a health FSA or DCAP may be limited to an amount not less than what the plan has already reimbursed
    b. Applicable to both general-purpose and limited-purpose health FSAs

Note: *Flexibility to make midyear pre-tax election changes is also available for plan years ending in 2021. The flexibility permitted for plan years ending in 2021 is more limited than that of plan years ending in 2020. Plan amendments reflecting pre-tax election change flexibility for plan years ending 2021 are required to be adopted by December 31, 2022.*

Extended Claims Period

Health FSA and DCAP plans with grace periods or plan years ending in 2020 (non-calendar year plans) were permitted to extend the period for participants to incur claims for these plans through December 31, 2020. The extension of time for incurring claims is available to §125 cafeteria plans with a grace period and plans that provide for a carryover.

Note: *Absent the temporary relief provided in the Notice, health FSAs can generally either adopt a grace period of up to 2 ½ months after the end of the plan year or provide for a carryover amount (limited to $500, as indexed), but cannot have both.*

Notice 2021-15

Relaxed Carryover Rules for DCAP and Health FSAs

Under the Notice, employers may adopt an optional rule that allows participants to carry over all unused funds from 2020 DCAP and health FSA plan year accounts to 2021 plan year accounts. Plan sponsors whose plans do not include a carryover provision or grace period may not amend their plans in a manner that takes advantage of both the relaxed carryover rules and the extended claims period relief (below). However, an employer can take advantage of the relaxed carryover relief even if the plan includes a standard grace period.

Note: *Employers may also permit participants to carry over all unused funds from 2021 DCAP and health FSA plan year accounts to 2022 plan year accounts. Plan amendments reflecting this change are required to be adopted by December 31, 2022.*

Extended Claims Periods for DCAP and Health FSAs

Employers were permitted to extend their DCAP, and health FSA account claims periods to 12 months after the end of the plan year for the plan year ending in 2020. Plans may not take advantage of both the relaxed carryover rules (above) and the extended claims period relief. However, an employer can take advantage of the extended claims period relief even if the plan includes a standard carryover provision.

Note: *Employers may also extend their DCAP, and health FSA account claims periods to 12 months after the end of the plan year for the plan year ending in 2021. Plan amendments reflecting this change are required to be adopted by December 31, 2022.*

Post Termination Reimbursements from Health FSAs

Employers were permitted to adopt a spend-down provision that allows employees whose participation in the health FSA terminated during the 2020 calendar year with remaining contributions in their health FSAs to receive reimbursements for qualifying expenses incurred after their termination dates. Under this provision, participants may continue to incur eligible expenses through the end of the plan year they were terminated, including any applicable grace period (such as an extended grace period adopted by the employer as outlined above). Because this is a permissive rule, rather than a mandate, employers may choose to adopt a provision that makes available to participants either the participant's entire annual election minus previous reimbursements or the participant's year-to-date salary reduction contributions minus previous reimbursements.

Before this relief, only DCAP plans could provide spend-down provisions.

Note: *Employers may permit employees who terminate participation during the 2021 calendar year with remaining contributions in their health FSAs to receive reimbursements for qualifying expenses incurred through the end of the plan year in which they were terminated. Plan amendments reflecting this change are required to be adopted by December 31, 2022.*

Temporary Rule Increasing the Maximum Age of Eligible Dependents for Use of DCAP Funds

Employers were permitted to allow reimbursement of otherwise eligible dependent care expenses for children up to the age of 14 (rather than age 13) during the 2020 plan year. They may also permit reimbursement of expenses for children up to the age of 14 during the 2021 plan year, but only regarding unused funds from the 2020 plan year. This relief applies to plan years for which the enrollment period ended on or before January 31, 2020.

Takeaways

If an employer has implemented any of the additional flexibility outlined above for the plan year ending in 2020, they should be sure that the Section 125 plan document has been amended, or will be amended by December 31, 2021, to properly reflect these changes. Plan sponsors providing temporary relief for the plan year ending in 2021 must amend their plans by December 31, 2022. Section 125 plan document amendments are required to be in writing. Therefore, the employer should be prepared to draft an amendment outlining the changes implemented. If the employer is utilizing a TPA for plan administration, the TPA may have already distributed a form to the employer, which could be adopted as an amendment that outlines the changes the employer has implemented in response to the IRS guidance addressed above.

Further, the employer should be prepared to follow any instructions outlined in the Section 125 plan document regarding the proper procedure for adopting the amendment. If the Section 125 plan document is silent as to the proper procedure for adopting plan amendments, the employer should discuss with legal counsel.

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